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**CORRESPONDENCE MEMORANDUM**

**DATE:** March 16, 2006  
**TO:** Members of the Employee Trust Funds Board  
**FROM:** Robert Weber, DETF Chief Counsel  
**SUBJECT:** Final Draft Report on Clearinghouse Rule #05-114, relating to separate retirement systems' investments in the Public Employee Trust Fund

This is an action item. The Board is asked to approve the Final Draft Report on this proposed rule. If the Board approves, then the Final Draft Report will be sent to the Legislature for its review. That is the final step before official promulgation of the rule.

The Employee Trust Funds Board has discretionary authority to allow other Wisconsin governmental retirement systems to invest in the Public Employee Trust Fund. If that is allowed, then the DETF Secretary is required to promulgate the rules governing the investments. Wis. ADMIN. CODE § ETF 10.12 was created in 1985 and revised twice before, effective in 1991 and 1998.

These latest revisions to the old rule will better reflect the investment performance of the fixed and variable retirement investment trusts, when valuing the investment accounts of separate retirement systems, by incorporating recommended financial industry practices. The proposed rule also assures full compliance with the statutory requirement for each separate retirement system to pay for the costs of investing and administering its funds sent to the DETF. Finally, the rule also assures that the Public Employee Trust Fund is in good faith compliance with the federal "exclusive benefit" rule by allowing investments only from other retirement systems that cover Wisconsin Retirement System (WRS) participating employees.

The rule language concerning valuation, investment performance and costs have been tested in actual practice. This language was worked out in discussions with the State of Wisconsin Investment Board staff, Milwaukee Public Schools (MPS) and the staff of the DETF Office of Trust Finance & Data Analysis. The MPS retirement system, which supplements WRS benefits for Milwaukee teachers, is currently the only separate retirement system with its retirement funds invested in the Public Employee Trust Fund.

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**STATE OF WISCONSIN  
DEPARTMENT OF EMPLOYEE TRUST FUNDS  
& EMPLOYEE TRUST FUNDS BOARD**

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**FINAL DRAFT REPORT ON CLEARINGHOUSE RULE # 05-114**

**FINAL RULE** to repeal s. ETF 10.12 (1) (d), renumber s. ETF 10.12 (1) (a), (b) and (c), renumber and amend s. ETF 10.12 (intro.), amend s. ETF 10.12 (4) (c) (intro.), repeal and recreate s. ETF 10.12 (2) and create s. ETF 10.12 (1r) (d), (4) (d), (5) and (6) regarding separate retirement system investments in the fixed and variable retirement investment trusts.

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### **Agency Person to be Contacted for Questions**

For questions about technical aspects of the proposed rule, please write or call Bob Willett, Director, Office of Trust Finance and Data Analysis, Department of Employee Trust Funds, P.O. Box 7931, Madison WI 53707. Telephone: (608) 266-0904. Fax: (608) 267-0633. E-mail bob.willett@etf.state.wi.us. For legal or procedural questions, please write or call Robert Weber, Chief Counsel, at the same DETF mailing address and fax number. Telephone: (608) 266-5804. Fax: (608) 267-0633. E-mail: rob.weber@etf.state.wi.us.

### **Statement Explaining Need for Rule**

When the Employee Trust Funds Board exercises its discretionary authority to allow separate retirement systems to invest in the Public Employee Trust Fund, then the DETF Secretary is required by Wis. STAT. § 40. 03 (2) (q) to promulgate the rules governing the investments. This rule-making is needed so that the valuation of those investments will more accurately reflect the actual investment performance of the fixed and variable retirement investment trusts. This rule is also necessary to assure good faith compliance with both: (1) the “exclusive benefit” rule of 26 U.S. Code §401 (a); and, (2) the requirement of Wis. STAT. § 40.03 (2) (n) for each separate retirement system to pay for the costs of investing and administering funds sent to the Department.

## **Analysis Prepared by the Department of Employee Trust Funds**

### **1. Statute interpreted:**

Wis. Stat. §§ 40.015 and 40.03 (1) (n) and (2) (q).

### **2. Statutory authority:**

Wis. Stat. § 40.03 (2) (q).

### **3. Explanation of agency authority:**

The Secretary of the Department of Employee Trust Funds is required to promulgate rules governing the times when separate retirement systems, such as the Milwaukee Public Schools Retirement System, may send or deliver funds to be invested as if part of the fixed or variable retirement investment trust, the withdrawal of those funds, the amounts of money that may be sent, delivered or withdrawn, the valuation of money that has been sent, delivered or withdrawn, and the distribution of investment income among the retirement systems. The Secretary's rules may also modify the basis for accounting or valuation and the investment earnings distribution procedures of the Wisconsin retirement system to the extent necessary to achieve equity among the various retirement systems.

### **4. Related statute or rule:**

Wis. Stat. § 40.03 (1) (n).

### **5. Plain language analysis:**

The proposed rule revision would better mirror the investment performance of the fixed and variable retirement investment trusts for purposes of valuing the investment accounts of separate retirement systems. The proposed rule will also better assure full compliance with the requirement of Wis. STAT. § 40.03 (2) (n) that each separate retirement system will pay for the costs of investing and administering funds sent to the Department of Employee Trust Funds.

The main purpose of the proposed rule revision in s. ETF 10.12 is to change the formulas used to value investments of separate retirement system accounts to be consistent with recommended financial industry practice. The revisions will also fine tune transaction definitions to facilitate the most effective implementation of the new formulas. For example, the rules concerning deposits are revised to allow deposits only on the last day of the month rather than the first day.

Section ETF 10.12 currently prescribes an investment valuation formula that is not totally consistent with recommended practice or conducive to establishing levels of process quality assurance. For example, the current rule does not enable a rate of earnings comparison between the separate accounts with the rate of earnings of the trust fund as a whole. Since the existing rule was first implemented, departmental experience and guidance from financial experts of the State of Wisconsin Investment Board have identified ways to improve the valuation method and to add procedures that will help ensure complete and accurate valuations.

In order to avoid violation of the exclusive benefit rule of 26 U.S. Code §401(a) and WIS. STAT. § 40.015 (1) the proposed rule will also limit the separate retirement systems who may invest in the Public Employee Trust Fund to those retirement systems, as defined by WIS. STAT. § 40.02 (51), providing additional pension benefits for employees covered by the Wisconsin Retirement System.

6. Summary of, and comparison with, existing or proposed federal regulations:

In order to be qualified under 26 U.S. Code §401(a)(2), A trust forming part of an employer pension plan must be for the exclusive benefit of the employees or their beneficiaries. It is prohibited to use or divert any part of the trust corpus or income for any other purposes.

7. Comparison with rules in adjacent states:

Permitting discretionary investment of a separate retirement system's funds in the public employee's retirement trust appears to be unique to Wisconsin, at least among neighboring states.

8. Summary of factual data and analytical methodologies:

The investment valuation calculation was developed in consultation with the State of Wisconsin Investment Board staff to more accurately mirror the investment performance of the Public Employee Trust Fund as a whole, to adopt industry best practices and to enable the investment and administrative costs for each separate retirement system's funds to be assessed.

9. Analysis and documents used to determine effect on small business:

WIS. STAT. § 40.02 (51) defines "retirement system" in a manner that necessarily excludes all private businesses. So the proposed rule has no effect whatsoever on small businesses.

10. Anticipated costs incurred by private sector:

None.

11. Statement of effect on small business:

The rule has no effect on small businesses.

**Regulatory Flexibility Analysis:**

The proposed rule has no direct effect on small businesses because it involves only the optional investment of the funds of retirement systems created by the state or a political subdivision of the state into the Public Employee Trust Fund created by WIS. STAT. § 40.01 (2) fulfill the benefit commitments to employees of state and local governments participating in the pension and benefit programs of ch. 40 of the statutes.

**Fiscal Estimate:**

The proposed rule has no fiscal impact on the liabilities or revenues of any county, city, village, town, technical college district or sewerage district and the only school district affected is the Milwaukee Public Schools. That is because, at present, Milwaukee Public Schools is the only separate retirement system investing its assets as permitted under Wis. Stat. § 40.03 (1) (n).

The effect of the proposed rule on the revenues and liabilities of the funds invested by the Milwaukee Public School retirement system, compared to the prior method of valuation is as unpredictable as future market experience on investments. The possible effects vary under different possible future scenarios. However, the proposed rule is more accurate than the present rule it replaces in reflecting the actual investment experience of the fixed and variable retirement investment trusts of the Public Employee Trust Fund in which the Milwaukee Public School retirement system funds are invested. This rule-making does not interfere with the existing ability of the trustees of the MPS retirement fund to withdraw their funds from investment in the Public Employee Trust Fund under WIS. ADMIN. CODE § ETF 10.12 (4) if such investment is no longer perceived as being in the best interests of the MPS trust fund. The only effect of this rule-making on the existing withdrawal provision is to change the effective date of the one withdrawal allowed each month.

## **Text of Rule**

**SECTION 1.** ETF 10.12 (intro.) is renumbered ETF 10.12 (1g) and amended to read:

ETF 10.12 (1g) PROCEDURE. The governing body of ~~the~~ a separate retirement system qualifying under sub. (5) may request participation in the retirement trust fund by the adoption of a resolution accepting the provisions of this section in a form approved by the department. A certified copy of the resolution shall be forwarded to the department and participation shall be effective on the first day of the month following board approval of the resolution under s. 40.03 (1) (n), Stats. Funds may be delivered or sent to the department subject to ~~the following:~~ this section.

**SECTION 2.** ETF 10.12 (1) (a), (b) and (c) are renumbered ETF 10.12 (1r) (a), (b) and (c).

**SECTION 3.** ETF 10.12 (1) (d) is repealed.

**SECTION 4.** ETF 10.12 (1r) (d) is created to read:

ETF 10.12 (1r) (d) Deposits to the fixed and variable retirement investment trusts shall be accepted on the last working day of the month only, even if actually received earlier. Each investment shall be effective the last day of the month for purposes of investment valuation.

**SECTION 5.** ETF 10.12 (2) is repealed and recreated to read:

ETF 10.12 (2) INVESTMENT VALUATION. Investments by a separate retirement system shall be valued as follows:

(a) The current market values of the fixed and variable retirement investment trusts shall be determined as of the close of the last calendar day of the month.

(b) The market gain or loss of the fixed and variable retirement investment trusts shall each be determined for the month, net of administrative and investment costs.

(c) Each separate retirement system's share of the respective retirement investment trust's market gain or loss shall be determined and credited effective the close of the last calendar day of the month.

(d) Each separate retirement system's share of the retirement investment trust's market gain or loss shall be calculated as the total retirement investment trust's gain or loss multiplied by that separate retirement system's proportionate share of the average daily net assets available for investment during the month.

(e) The fixed or variable retirement investment trust's average daily net assets

available for investment during the month shall be calculated as the sum of its daily beginning asset balances divided by the number of calendar days in the month.

(f) Each separate retirement system's average daily net assets available for investment during the month shall be calculated as the sum of its daily beginning asset balances divided by the number of calendar days in the month.

**SECTION 6.** ETF 10.12 (4) (c) (intro.) is amended to read:

ETF 10.12 (4) (c) (intro.) Withdrawals by a separate retirement system shall be limited in any calendar month to one withdrawal paid on the ~~first~~ last working day of the month of the greater of:

**SECTION 7.** ETF 10.12 (4) (d) is created to read:

ETF 10.12 (4) (d) For investment valuation purposes, withdrawals shall be treated as if effective at the close of the last calendar day of the month.

**SECTION 8.** ETF 10.12 (5) is created to read:

ETF 10.12 (5) PARTICIPATING EMPLOYERS ELIGIBLE. (a) "Separate retirement system" for purpose of this section and s. 40.03 (1) (n) and (2) (q), Stats., means a pension benefit plan which is all of the following:

1. Established by the state or a political subdivision of the state which is also a participating employer subject to the provisions of the Wisconsin retirement system under s. 40.21, Stats.

2. A governmental plan as defined by 26 U.S.C. § 414(d) and 29 U.S.C. 1003(32).

3. Qualified for federal tax purposes under the applicable provisions of the internal revenue code.

4. Maintained and administered for the exclusive benefit of the employees of that employer and their beneficiaries.

(b) Any separate retirement system that fails to certify upon the department's request, and at least annually, that it continues to meet the criteria of par. (a), and any separate retirement system that the department determines does not meet the criteria of par. (a), shall be compelled to withdraw its entire investment as rapidly as permitted under sub. (4).



**SECTION 9.** ETF 10.12 (6) is created to read:

ETF 10.12 (6) TERMINATION OF PROGRAM. The employee trust funds board or the secretary of the department may close the investment option under s. 40.03 (1) (n), Stats., to any or all separate retirement systems and compel withdrawal of investments under sub. (4) if the board or the secretary determines that the separate retirement system investment interferes with the duty to manage, administer, invest and otherwise deal with the public employee trust fund solely for the benefit of the participants in the benefits plans under ch. 40, Stats., and their beneficiaries as provided in that chapter.

(end of rule text)

**Effective Date**

This rule shall take effect on the first day of the month following publication in the Wisconsin Administrative Register as provided in Wis. Stat. s. 227.22 (2).

**Legislative Council Staff Clearinghouse Report on CR #**

Insert Page 1 of Legislative Council Clearinghouse Report here. The report is not available in Word format.

**Legislative Council Staff Clearinghouse Report on CR #**

Insert Page 2 of Legislative Council Clearinghouse Report here. The report is not available in Word format.

**Legislative Council Staff Clearinghouse Report on CR #**

Insert Page 3 of Legislative Council Clearinghouse Report here. The report is not available in Word format.

### **Response to Legislative Council Staff Recommendations**

The DETF implemented all the Legislative Council Staff recommendations. The recommendations concerned only the proper format for the reference to Wis. STAT. § 40.03 (1) (n) and (2) (q) in the proposed Wis. ADMIN. CODE § ETF 10.12 (5) (a) (intro.) and the references to Wis. STAT. § 40.03 (1) (n) and Chapter 40 in the proposed Wis. ADMIN. CODE § ETF 10.12 (6) plus the correction of a typographical error in the latter subsection. These changes have no substantive effect upon the rule or its analysis.

### **List of Persons Appearing or Registering For or Against the Rules.**

No persons registered either for or against the rule at the public hearing on January 24, 2006.

### **Summary of Comments Received at Public Hearing.**

No person wished to testify concerning the rule. The record was held open for written comments until 4:30 p.m. on Wednesday, January 25, 2006, but no comments were received.

### **Modifications to Rule as Originally Proposed as a Result of Public Comments**

None.

### **Modifications to the Analysis Accompanying the Proposed Rule.**

None.

### **Modifications to the Initial Fiscal Estimate**

The Fiscal Estimate has been slightly revised to add to the explanation of the effects of the rule regarding the Milwaukee Public Schools retirements system. The MPS retirement system funds are currently the only separate retirement system funds invested in the Public Employee Trust Fund.

### **Board Authorization for Promulgation**

This final draft report on Clearinghouse Rule #05-114 has been duly approved for submission to the Legislature, and for promulgation, by the Department of Employee Trust Funds and by the Employee Trust Funds Board at its meeting on March 31, 2006.

Respectfully submitted,

**DEPARTMENT OF EMPLOYEE TRUST FUNDS**

\_\_\_\_\_  
Eric O. Stanchfield  
Secretary

Date: \_\_\_\_\_